

Service Date: May 17, 1991

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER of the Investigation)	UTILITY DIVISION
and Monitoring of Butte Water)	
Company's Capital Improvement Plan)	DOCKET NO. 90.12.93
and Financing Efforts.)	ORDER NO. 5536a

FINAL ORDER

APPEARANCES

FOR THE APPLICANT:

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FOR THE COMMISSION:

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BEFORE:

HOWARD L. ELLIS, Chairman
DANNY OBERG, Vice-Chairman
BOB ANDERSON, Commissioner
JOHN B. DRISCOLL, Commissioner
WALLACE W. "WALLY" MERCER, Commissioner

BACKGROUND

On December 21, 1988 the Montana Public Service Commission (Commission) issued Order No. 5387 in Commission Docket No. 88.9.29. The Commission found that Butte Water Company (Company or BWC) had inadequate utility facilities and serious service related problems caused by facility inadequacies. The Commission ordered BWC to provide within 60 days of the date of the Order a capital improvement plan for rectifying the facility deficiencies noted in the Order.

On February 23, 1989 BWC filed its initial proposed capital improvement plan for correcting system deficiencies. In Order No. 5387a, issued March 3, 1989, the Commission found BWC's response to the Adequacy of Service Order "insufficiently responsive and a failure and refusal to comply with a lawful order of the Commission." The Commission in this Order gave BWC an additional seven days to submit a compliance plan indicating how it would make the improvements to the water system determined necessary in Order No. 5387.

On March 9, 1989, rather than comply with the Commission's Adequacy of Service Orders, BWC filed a Petition for Judicial Review of Commission Order No. 5387 in the First Judicial District, Lewis and Clark County, Montana.

On March 10, 1989 the Commission filed a complaint in the Second Judicial District, Silver Bow County, Montana, against BWC on violations of Order Nos. 5387 and 5387a and violations of its duty to provide the public with reasonably adequate service and facilities. The complaint requested fines against BWC for failure to comply with a lawful order of the Commission and failure to discharge its statutory public utility obligation. The Commission's complaint and BWC's petition were consolidated under Cause No. 89-C-138, Second Judicial District, Silver Bow County.

On August 17, 1989 the Commission issued Order No. 5382b in Docket No. 88.9.29, denying BWC's request for increased rates and charges in its Butte, Montana service area, based upon BWC's failure to discharge its primary utility obligation to provide reasonably adequate service and facilities.

On October 13, 1989 the Legislative Consumer Committee of the State of Montana convened a public hearing in Butte, Montana to discuss the unwillingness and/or inability of BWC to cooperate with regulatory agencies and comply with regulatory requirements of the Commission and the Montana Department of Health and Environmental Sciences (DHES). The purpose of this hearing was to obtain information so that the Consumer Committee could decide actions to take to gain improved service and facilities for BWC consumers. During this hearing BWC represented its willingness to start a new era of cooperation with the regulatory agencies. BWC further represented its commitment to resolve the service and facility problems in its Butte service area.

On October 16, 1989 the DHES filed suit against BWC in the Second Judicial District, Silver Bow County, Cause No. 89-C-435. DHES alleged violation of health

standards imposed on BWC as a public water supply and requested an order from the court directing BWC to correct the health violations.

On December 1, 1989 BWC filed a Notice of Filing of Capital Improvement Plan in consolidated Cause No. 89-C-138 and with the Commission in Docket No. 88.9.29. BWC also filed an amended Motion for Reconsideration of Commission Order No. 5382b. The Commission through its Order No. 5387b accepted BWC's improvement plan as being responsive to the Commission's original order directing BWC to provide a plan to correct system deficiencies. The amended motion alleged a change of facts since the issuance of Commission Order No. 5382b and BWC's filing of its previous Motion for Reconsideration and provided additional grounds for the Commission to reconsider Order No. 5382b. After review of the Amended Motion for Reconsideration and the supporting brief, the Commission on its own initiative reopened Docket No. 88.9.29 for the taking of additional evidence.

On February 21, 1990 this Commission issued Order No. 5382c in Docket No. 88.9.29. In this Order the Commission reconsidered its position denying increased rates and charges to BWC, even though substantial improvement to the facilities had not yet occurred. The Company, through its testimony, convinced the Commission that without increased rates BWC would not have the basic financial resources necessary to commence improving service or to gain access to the capital markets. In Order No. 5382c the Commission stated:

[T]he main objective of the Commission is to compel BWC, by whatever means are at its disposal, to improve service and facilities in its Butte service area. To achieve the goal of improving service, the Commission in the exercise of its

regulatory powers will support BWC in its efforts to obtain the necessary resources to accomplish the task....

On or about March 8, 1990 a class action lawsuit was filed against BWC in the Second Judicial District, Silver Bow County, Cause No. 90-C-90, seeking compensation for subscribers connected to the BWC water system.

On May 7, 1990 this Commission filed in the Second Judicial District, Silver Bow County, Cause No. 90-C-192, an Application for Writ of Mandate against BWC. This filing requested an order from the Court compelling BWC to make necessary capital improvements to its water system during the 1990 construction season in compliance with this Commission's Order No. 5387b.

In May, 1990 the Butte-Silver Bow government and Butte Water Company concurrently submitted applications for a \$10,000,000 loan from the Department of Natural Resources and Conservation (DNRC). Per the submitted application, the proceeds from this loan, upon approval from DNRC and the Montana Legislature, would be used to fund construction of proposed 1991 and 1992 capital improvements to the BWC system.

On May 25, 1990 BWC and this Commission entered into a stipulation resolving the issue of capital improvements to be completed during the 1990 construction season. On June 22, 1990 in Cause No. 90-C-192, the Court issued its order accepting the stipulation between the parties pursuant to the Commission's Application for a Writ of Mandate.

On November 15, 1990 BWC filed an application with this

Commission requesting authority to increase rates and charges to its Butte, Montana customers. BWC requested authorization to increase rates on an interim and permanent basis by \$1,129,716.

On November 27, 1990 the Commission, having considered the data filed with BWC's request for an interim application, issued Order No. 5518 in Docket No. 90.11.77. This order authorized BWC interim rate relief in the amount of \$1,129,716.

On December 28, 1990 the Commission issued Order No. 5536 in Docket 90.12.93. This order required BWC to appear before the Commission and present testimony and documentation on its efforts to obtain financing for necessary capital improvements. The Commission ordered BWC to appear and present testimony consistent with the provisions of Order No. 5387b, Docket No. 88.9.29.

In December, 1990, just prior to the start of the 1991 Montana Legislative session, DNRC informed the Butte-Silver Bow Council of Commissioners that it would not support the pending funding application in the 1991 Legislature. DNRC indicated that it would not support the application because no stipulation had been entered into between BWC and the class action participants. The Butte-Silver Bow Council of Commissioners decided to withdraw the funding application rather than have it presented to the Legislature with a potential negative recommendation from DNRC.

On February 11, 1991, after proper notice, a hearing was held in the Commission Offices, 2701 Prospect Avenue, Helena, Montana. The purpose of the public hearing was to receive evidence from BWC on its efforts to obtain the necessary capital to make improvements to the water system as ordered by this Commission.

FINDINGS OF FACT

Summary of Testimony

At the public hearing the Applicant presented the testimony and exhibits of the following witnesses:

James Chelini, President & General Manager, BWC
Bob Peccia, Consulting Engineer
Don Cox, Controller, BWC
Mark Semmens, V.P. Investment Banking, D. A. Davidson & Co.

These witnesses presented testimony regarding BWC's proposed capital improvement program; BWC's activities relative to potential issuance of private activity bonds for funding capital improvements; contacts with lending institutions for the purpose of obtaining conventional financing; contacts with entities proposing to construct facilities that would be leased to BWC until conventional financing could be obtained; BWC's and Butte-Silver Bow's applications for a loan from the Montana Department of Natural Resources and Conservation; factors impairing BWC's ability to attract debt and equity capital; and efforts undertaken to mitigate the effects of the impediments to BWC's ability to attract debt and equity capital.

BWC operating officers and financial witnesses testified on February 11, 1991 on the historical and current efforts of BWC to obtain financing to make necessary capital improvements. James W. Chelini, President of BWC, testified that upon concluding that system improvements were needed, the company began in early 1986 to attempt to secure financing to construct improvements. After initial efforts to obtain financing failed, it was determined that it would be appropriate to have a master plan developed for the

water system that identified system deficiencies and quantified improvement costs. BWC and a community ad hoc committee engaged the services of a consulting engineering firm to prepare a master plan that identified system deficiencies and potential corrective actions to remedy those deficiencies. The master plan cited significant deficiencies in the distribution system, transmission system, filtration facilities and distribution system storage. The consultants proposed a number of options for correcting system deficiencies, all of which required substantial capital investment in utility plant. Mr. Chelini testified that BWC continued looking for capital after receipt of the master plan. However, based upon historic financial performance, minimal rate base and the substantial investment required, BWC could not demonstrate to the financial community that it could service a sizable debt requirement. Mr. Chelini testified that BWC first contacted D.A. Davidson and Piper, Jaffery in 1987 for assistance in acquiring debt capital to finance system improvements. The initial contacts with these companies did not result in financing.

Don Cox, Controller of BWC, testified that formal requests made to financial institutions for conventional financing had been denied because of the past earnings history of the utility and the historical regulatory environment. He testified that BWC had attempted to structure an arrangement with Business Financial Services (BFS) for construction of the west side storage facility, in which BFS would construct and own the facility which it would lease to BWC. This proposed arrangement apparently was never consummated because of BFS's reluctance to own a facility in an EPA Superfund area. Mr. Cox testified that BWC and Butte-Silver Bow concurrently filed applications with DNRC for capital improvement funding. Mr. Cox indicated that to participate in any funding of

improvements, DNRC required a stipulation between BWC and the class action participants that would protect the DNRC investment in the utility. In discussing the proposed DNRC funding, Mr. Cox testified that at the time of the hearing he did not know whether DNRC was willing to support the funding proposal in front of the Legislature, even if BWC and the class action plaintiffs entered into a stipulation.

Mark Semmens, Vice President of D. A. Davidson and Co. (DAD), testified that Mr. Chelini contacted him in 1987 to request assistance in obtaining financing for capital improvements to the Butte Division of BWC. At that time, DAD determined that it was unable to provide the assistance requested by BWC due to BWC's limited rate base and "ordinary ratemaking procedures" used by the Commission. In the fall of 1989, however, Mr. Semmens met with the company, Commission staff and staff of the Montana Consumer Counsel to investigate potential financial and ratemaking solutions that would respond to the unique circumstances of BWC and potentially allow DAD to participate in brokering debt. By March 1990, after detailed discussions and agreement on several key provisions, DAD was comfortable with a financing plan requiring a 60/40 debt/equity ratio for the company. The shareholder would make an appropriate investment of equity and "near" equity (shareholder loans) to meet this requirement, with DAD underwriting the balance of necessary debt to complete the program.

Mr. Semmens testified that the filing of the class action lawsuit precluded BWC from securing financing through DAD because of the contingent, unspecified and unknown financial liability. Mr. Semmens indicated that DAD's bond counsel advised that it would be unable to provide a favorable bond opinion with the class action pending. To

get by this hurdle, he testified that BWC's counsel suggested a stipulation between BWC and the class action plaintiffs providing that any class action judgment not attach to any of the physical assets of BWC or net incomes necessary to service newly-attracted debt. However, a damage award could attach to a portion of the company's income generated by the existing rate base on a subordinate claim basis. Until the class action is satisfactorily resolved by stipulation or otherwise, DAD has decided it cannot participate in underwriting a debt issue for BWC, Mr. Semmens testified.

According to Mr. Semmens' testimony, after the lawsuit was filed DAD continued working with BWC and explored other possibilities for BWC to obtain financing. Piper, Jaffery, another brokerage firm, joined DAD as a potential co-manager in underwriting any proposed debt. Together they considered marketing a debt issue through use of credit enhancement or some other form of outside commitment to guarantee a potential debt obligation of BWC. The firms were concerned that execution of a stipulation in the class action standing alone, without credit enhancement, would not be sufficient for the firms to sell debt to prospective purchasers of the debt issue. In May, 1990 and again in February, 1991 Mr. Semmens discussed the possibility of a letter of credit from the Bank of Montreal as credit enhancement. Given the circumstances, the Bank of Montreal declined.

Under cross-examination, Mr. Semmens testified that he did not have the written commitment of the shareholder to contribute appropriate equity and near equity required under DAD's proposal. However, there was a clear understanding that the shareholder would do so.

Under further cross-examination, Mr. Semmens testified that he was first made aware of pending wrongful discharge litigation against BWC in December 1990. When asked if this lawsuit represented an impediment to BWC obtaining financing for capital improvements, Mr. Semmens responded that it could prevent financing but that determination would be left to legal counsel.

The Intervenor presented the testimony of one expert witness, Thomas J. Schneider. Mr. Schneider testified and sponsored a stipulation that he proposed could be entered into between the class action plaintiffs and BWC. Mr. Schneider explained that the terms and conditions of the proposed stipulation were acceptable to the class action plaintiffs for satisfaction of any potential judgment against BWC. Mr. Schneider testified that he and the attorneys for the class action plaintiffs had drafted the proposed stipulation the morning of the public hearing. At the time of Mr. Schneider's testimony, BWC had not received the proposed stipulation for review and comment. The Commission in this order will not comment on the merits of this proposed stipulation, but it recognizes that BWC and the class action participants have exchanged numerous versions of a proposed stipulation in a failed effort to remove the class action suit as a potential impediment to capital attraction.

DISCUSSION AND FURTHER FINDINGS

The Commission maintains its continuing objective that BWC provide adequate service and facilities for its customers. The Commission has supported BWC in its efforts to obtain financing to accomplish the task of bringing its facilities and service into compliance with Commission orders. To this end the Commission granted two rate increases. The first rate increase in February, 1990 allowed the company basic financial resources to begin improving service and facilities, resulting, in part, in necessary capital improvements being constructed during the 1990 construction season. The second rate increase in November, 1990 provided expedited capital cost recovery associated with 1990 capital improvements. In Adequacy of Service Order No. 5387 in 1988, the Commission had committed to expedited proceedings upon completion of improvements. The November order fulfilled the Commission's commitment to expedite proceedings to place newly constructed used and useful facilities in rate base.

The Commission will not burden this order by reiterating BWC's service and facility deficiencies. In this monitoring proceeding on financing for needed capital improvements, the Commission needs to determine only whether the improvements proposed for the 1991 construction season meet the parameters of Commission Order No. 5387c. Based on the Applicant's presentation at the hearing, the Commission can conclude that the improvements proposed for 1991 construction season comply with Order No. 5387c.

On April 2, 1991 BWC filed a revision to its proposed 1991 construction program for Commission review and acceptance. In the revised plan, BWC indicates that due to lower than expected yields from the Ranney collector system and significantly increased capital costs for this alternative, it has abandoned this proposal. The Ranney collectors proposed to be constructed on the Big Hole source of supply during the 1991 construction season were an alternative to conventional filtration. Filtration of this source of supply is one of the requirements imposed on BWC by this Commission and the DHES. BWC's decision to abandon the Ranney collector system in favor of conventional filtration means that commencement of construction on a filtration process will be deferred one year. BWC's revised improvement program meets the 1993 deadline for completion of this capital improvement requirement. Since construction of a filtration process will be delayed one year, BWC proposed to accelerate distribution system improvements doubling the amount originally to be constructed during 1991.

The Commission convened the hearing in this Docket to ascertain current financing activities undertaken by BWC and prospective financing alternatives available to BWC for construction of needed capital improvements. The Commission has determined that BWC's April 2, 1991 capital improvement program complies with its adequacy of service order. However, BWC has demonstrated in this proceeding that it is unable to attract the capital necessary to construct those improvements for either 1991 or the remaining construction program.

The Commission, since its initial determination that BWC's facilities are inadequate, has maintained that failure to make necessary improvements due to

inadequate financial resources is not a valid argument for any public utility failing to discharge its public utility obligation. Pursuant to its supervisory and regulatory powers, the Commission will continue to use all tools at its disposal to correct the problems of BWC and achieve the goal of improving service and facilities to BWC's customers. The Commission's objective has remained constant but its efforts have met with limited success, due to circumstances beyond the Commission's control.

BWC's cooperation with the Commission since October, 1989 has resulted in extensive efforts by numerous parties to develop a reasonable capital improvement program and to obtain financing for the program. BWC has complied with the Commission's orders and filed its capital improvement plan for the entire construction program through 1993. Although there was a brief challenge to the Commission's authority in May, 1990, BWC and the Commission stipulated to a capital improvement program for the construction season of 1990 to satisfy DHES requirements for storage and chlorination and the Commission's requirements for distribution system improvements. As indicated in the Commission's Adequacy of Service Order No. 5387 in Docket No. 88.9.29, the Commission allowed increased rates for improvements once the improvements became used and useful in the provision of service.

In this proceeding BWC has demonstrated an inability to attract capital to commence construction of the balance of the 1991 capital improvement program as accepted by the Commission. These improvements are necessary if BWC is to discharge its statutory public utility obligation. BWC has further demonstrated that it cannot financially commit to the entire capital improvement program as filed with and accepted by

the Commission. The Commission has given every consideration and possible assistance to BWC to enable it to fulfill its public utility obligation. In response, BWC has exhaustively explored conventional and unconventional avenues of financing and demonstrated that it cannot attract the capital necessary to complete its capital improvement program.

Circumstances inhibiting investment from the financial community also inhibit shareholder equity and/or debt investment. The Commission finds that historically BWC's management decisions and failure to make necessary, timely improvements have led to the current impasse requiring this Commission Order. Under the present circumstances, however, BWC cannot obtain financing to make necessary improvements from investors, including the present shareholder, other potential shareholders, or lending institutions. Because of this impasse at this critical time, the Commission finds no recourse other than this Order to BWC to divest its holdings to an entity which will not have these impediments.

BWC has demonstrated its willingness to comply with the Commission orders and has taken reasonable actions to obtain the necessary financing to complete its capital improvement program. This order has outlined many of BWC's difficulties and its apparent inability to overcome them. Therefore, the Commission determines that as the agency charged with insuring the discharge of the public utility obligation by a public utility, it is in the public interest for BWC to convey ownership of its public utility holdings to an entity capable of and committed to arranging the necessary financing to complete the required capital improvement program. The conveyance shall be structured so that any

and all impediments preventing BWC from attracting the necessary capital are removed.

The Commission, having found that BWC is presently incapable of discharging its public utility obligation, finds that BWC should be allowed no further increases in rates and charges. The Commission will reconsider this finding when BWC presents substantial credible evidence that it can discharge its public utility obligation.

BWC will place an advertisement for sale in trade and business publications of national and local circulation. The advertisement will run more than once in those publications published more often than monthly. BWC shall also have prepared a sales brochure that may be sent to any prospective purchaser. BWC shall submit copies of both the advertisement and the sales brochure to this Commission. Along with the advertisement, the company shall provide the Commission a listing of the publications and the dates of advertisement.

Upon contact by each potential prospective purchaser, BWC shall immediately notify and inform the Commission of the name, business address, telephone number, and a contact person of the prospective buyer. Butte Water shall also inform the prospective buyer that this information is being provided to the Commission and that the Commission may make inquiry of the purchaser. The Commission's resources will be made available to any prospective purchaser so that it may become fully informed on the public utility obligation and financing and procedural requirements to meet this obligation.

CONCLUSIONS OF LAW

The Montana Public Service Commission is invested with full power of supervision, regulation and control of public utilities, subject to the provisions of Title 69, Chapter 3. Section 69-3-102, MCA.

Butte Water Company is a public utility subject to the Commission's jurisdiction. Section 69-3-101, MCA.

The Commission has the general power to do all things necessary and convenient in the exercise of its powers under Title 69, Chapter 3, and has the power to regulate the manner of all investigations and hearings of the public utilities before it. Section 69-3-103, MCA.

The Commission has full authority to inquire into the management of the business of all public utilities, to keep itself informed, and to obtain from the public utility all necessary information to perform its duties. Section 69-3-206, MCA.

A public utility has the duty to provide adequate service and facilities at reasonable rates. Section 69-3-201, MCA.

If, upon hearing and due investigation, the Commission determines that service is inadequate or that any reasonable service cannot be obtained, the Commission may make such order related to service as is just and reasonable. Section 69-3-330, MCA.

As a matter of law, Butte Water Company is unable to discharge its public utility obligation and to obtain financing for a capital improvement program in order to provide adequate service and facilities.

ORDER

WHEREFORE, having exhausted all apparent remedies to enable Butte Water Company to fulfill its public utility duty to provide adequate service and facilities, the Commission enters the following order as a just and reasonable recourse to remedy the problem:

Butte Water Company shall convey its public utility holdings and operation to a qualified buyer capable of obtaining the necessary financing to complete the required capital improvement program.

Butte Water Company shall prepare an advertisement for sale to be placed in state and national publications and provide the Commission with a copy of the advertisement as well as a listing of the publications and dates of advertisement. The advertisement shall appear more than once in each of the publications.

Upon contact by each potential prospective purchaser, Butte Water Company shall immediately notify and inform the Commission of the name, business address, telephone number, and a contact person of the prospective buyer. Butte Water shall also inform the prospective buyer that this information is provided to the Commission.

Before a sales transaction is completed, Butte Water Company and the Buyer shall present written documentation to the Commission warranting that there will be no impediments to financing and completing the capital improvement program as filed and accepted by the Commission.

If Butte Water Company can obtain the financing necessary to complete the entire capital improvement program, beginning with the 1991 construction season, the Commission will relieve Butte Water Company of the obligation to sell. Butte Water Company shall file written documentation with the Commission stating its intent to complete the program as filed with the Commission and demonstrating its ability to obtain the necessary financing.

By August 1, 1991 Butte Water Company shall either convey its public utility holdings to a qualified buyer accepted by the Commission or demonstrate its ability to complete the entire capital improvement program.

BWC will be authorized no further increases in rates and charges pending a demonstration that it can discharge its public utility obligation.

DONE IN OPEN SESSION at Helena, Montana, this 15th day of May, 1991 by a vote of 5 - 0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

HOWARD L. ELLIS, Chairman

DANNY OBERG, Vice Chairman

BOB ANDERSON, Commissioner

JOHN B. DRISCOLL, Commissioner

WALLACE W. "WALLY" MERCER, Commissioner

ATTEST:

Ann Peck
Commission Secretary

(SEAL)

NOTE: Any interested party may request that the Commission reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.